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**Keeping For-Sale Units Affordable Over Time:
One Important Step in Administering a Successful Inclusionary
Zoning Program**

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Introduction

The majority of inclusionary zoning ordinances nationwide include an affordability control period for both rental units and owner-occupied units. These range in time from ten years to perpetuity. Keeping rental units affordable over time rarely presents a challenge; in fact, numerous state and federal financing programs include control periods for rental units produced under the programs. However, communities often lack successful models for keeping for-sale units affordable over time.

Resale prices on affordable owner-occupied units can be controlled. Deed restrictions, covenants that run with the land, contractual agreements, and land trust arrangements have all been used successfully in various communities around the country.¹ Examples from Massachusetts, Montgomery County, Maryland, and San Diego, California all provide useful models for keeping for-sale units affordable over time.

Models

Inclusionary housing programs can be structured in different ways to keep for-sale housing units affordable over time. The specific structure of affordability controls on for-sale units should be dictated by a local government's policy goals. If a local government's primary goal is to revitalize economically depressed areas and build wealth and equity among historically disadvantaged groups, then shorter control periods would be most appropriate. However, if a local government's primary goal is the preservation and production of an attractive supply of affordable housing for the social, workforce, and economic development needs of the community, then longer control periods would be a better choice. Some communities may wish to target their control period policies to meet a combination of both policy goals.

Chapter 40B in Massachusetts

In 1969 Massachusetts passed a zoning law known as Chapter 40B. The law was meant to address the statewide shortage of affordable housing by giving developers two mechanisms to overcome local government obstacles to affordable housing developments. Chapter 40B homes are all deed restricted, and the deed restriction requires that a monitoring agent oversee the sale of affordable housing units. The monitoring agent ensures that the home is resold to an eligible buyer at an affordable purchase price without any major equity sharing for the original buyer. When the control period ends, the owner may sell to any buyer as long as the extra profit is turned over to the municipality or to another appropriate entity identified in the deed restriction.

Montgomery County, Maryland

The deed restriction in Montgomery County, Maryland requires that affordable homeownership units be resold to eligible buyers at the original purchase price, plus the annual increase in the Consumer Price Index related to home construction. At the end of the control period, the owner may sell to any buyer and retain a certain amount of the higher resale price, provided that the excess profit is paid to the Housing Initiative Fund of Montgomery County.

¹ Business and Professional People for the Public Interest, *Opening the Door to Inclusionary Housing*, 39.

San Diego, California

The City of San Diego, California recently adopted an inclusionary zoning ordinance that makes the equity a homebuyer receives for the sale of an inclusionary unit contingent on the length of time the unit owner lived in the home. This mechanism allows the city to strike a balance between keeping the city's housing stock affordable over time while allowing homeowners to receive equity from their investment.

Community Land Trusts

Under the Community Land Trust model, the Trust leases land to homeowners. The homes built on this land cannot be sold above a maximum resale price. This price allows the seller to keep some percentage of the increase in the appraised value of the home, based on the appreciation in the market value of the home. Either the municipality or the trust in each of these programs is guaranteed the right of first refusal as to the purchase of the affordable housing units upon expiration of the control period.

These four options provide alternative models for keeping owner-occupied homes affordable over time. All four provide a slightly different way to balance the policy goal of preserving long-term affordability with the policy goal of providing low-income households with the opportunity to build wealth and equity.

I. Massachusetts

Massachusetts keeps its Chapter 40B housing units affordable through deed restrictions overseen by monitoring agents. All 40B units must be sold and resold at prices affordable to households earning less than 80 percent of the area median income (AMI). The affordability of the homeownership housing units is guaranteed through three important documents: the regulatory agreement, the monitoring services agreement, and the deed rider. These documents are signed by the developer and the lender, and the municipality may also choose to be part of this agreement.

A. Setting an Affordable Sales Price

The monitoring agent is responsible for working with the seller to determine an affordable sales price. The monitoring agent also ensures that the profit to the developer or any other shareholder does not exceed the maximum allowable profit (e.g. 20 percent of total development costs, not including development fees). The developer pays for the services of the monitoring agent at the beginning of the agreement. Monitoring services for the resale of affordable units are paid for through closing costs as a percentage of the resale price.

The affordable sales price determined by the monitoring agent and the seller is based on the 80 percent of AMI limit on the prospective buyer's income. This is a newer method, as the first approach to ensuring affordable resale prices proved untenable.² Originally, the regulatory agreement established a ratio between the market value of the 40B unit and the affordable sales

² Phone interview with Bill Reylet, Massachusetts Department of Housing and Community Development August (2003).

price. This ratio would have to hold over time, such that it would apply to the market value at the time of resale. However, this method failed due to the dramatic increase in the market value of housing. Housing costs rose considerably more than incomes, such that when the ratio was applied to the market value at the time of resale, it no longer yielded an affordable sales price. For this reason, the monitoring agent now bases affordability on the incomes of households earning 80 percent of AMI.

The developer must require the buyers of affordable units to execute a deed rider that requires the unit owner to notify the monitoring agent at the time of resale.³ The monitoring agent and the owner then come up with a marketing plan that must be approved by the subsidizing agency, which is usually either the Massachusetts Department of Housing and Community Development (DHCD) or the Massachusetts Housing Partnership.⁴ Upon resale, the owner works with the monitoring agent to establish a maximum sales price. This price cannot be less than the price paid by the current owner, and it must include the costs of marketing expenses and approved improvements to the property.⁵

While there is no equity sharing, the final sales price is designed to reasonably compensate the owner for the money put into the property. The owner does not keep any of the profit after selling the property.

B. Selecting an Eligible Buyer

Once the discounted sales price is determined, the owner must offer the unit for sale to the municipality, which has the right of first refusal. If the municipality declines to purchase the housing unit, then the seller must work with the monitoring agent to ensure that the prospective buyer earns less than 80 percent of AMI. Particular housing units are generally matched to household sizes that equal the number of bedrooms plus one. Exceptions can be made in some instances. For example, a single parent with two children who are over the age of eight and of opposite sexes may qualify for a three-bedroom household.

If multiple eligible buyers are found, then generally the municipality chooses the ultimate buyer by lottery. The details of the lottery are a part of the original marketing plan devised by the monitoring agent and the owner. If the municipality does not take part in the lottery process, it can be carried out by the developer, hired consultants, or the monitoring agent. The monitoring agent then signs and acknowledges the Eligible Purchaser Certificate, which confirms the property, purchaser, sales price, and overall legitimacy of the sale.

³ The resale procedure outlined here is based on the provisions of a sample regulatory agreement and deed rider, which were provided by Bob Engler, an affordable housing developer in Massachusetts.

⁴ All affordable units under 40B are state or federally subsidized.

⁵ It is highly unlikely that any approved improvements to the property would have a sizeable effect on the sales price. This is because large-scale improvements, such as a three-room addition, would probably not be approved by the monitoring agent and the subsidizing agency. There is no formal process for determining what improvements are acceptable. Improvements to the property are approved on a case-by-case basis, but substantial modifications are generally not authorized.

For the first 120 days the housing unit is on the market, the owner is required to make the unit available for purchase only to eligible buyers. After this period, the owner may offer the housing unit for sale to the general public. In this event, the unit will be free of any future sale restrictions, but the seller must turn over to the municipality any profit on the sale. This profit, which is the difference between the maximum sales price and the actual sales price, will be paid to an affordable housing fund used by the municipality. In the event that the municipality is not involved and does not have a housing fund, the profit will be directed to some other entity that is specified in the regulatory agreement. The vast majority of municipalities do have a fund, and otherwise profits are generally directed back into the project from which they arose.

C. Sale after the Expiration of the Control Period

Both the regulatory agreement and the deed rider make provisions for the end of the control period. The agreements expire after ninety-nine years, but the provisions of these two documents that address the end of the control period will survive the expiration of the agreements themselves. When the control period ends, the housing unit will be sold for its fair market value. However, the owner must nevertheless determine what the maximum sales price would be as if there were still a price control. Upon resale, the owner must pay any amount in excess of the maximum sales price to the municipality or any other entity specified in the regulatory agreement. Alternatively, the owner may make a payment to the municipality through refinancing or other sources that would equal the amount the municipality would receive from resale. In that case, the owner would hold the property free and clear of all prior restrictions.

II. Montgomery County, Maryland

In 1974, Montgomery County, Maryland put into place the first mandatory inclusionary zoning law in the United States. The Moderately Priced Dwelling Unit Program (MPDU) requires that every new development with more than 35 housing units set aside 12.5 to 15 percent of the units to be affordable to households earning at or below 65 percent of the area's median income.⁶ These units must remain affordable for a period of ten years.⁷ The Department of Housing and Community Affairs (DHCA) guarantees the affordability of the housing during this control period by restricting the sale prices and reserving the right of first refusal on the purchase of any affordable unit put up for sale.

A. Setting an Affordable Sales Price

Montgomery County has precise regulations regarding the sales prices of affordable housing units. The County Executive determines the initial sales price for low- and moderate-income households based on general market trends and statistics collected from the building industry, area employers, and professional and citizen groups. The sales price takes into account closing costs as well as brokerage fees.⁸ The County Executive determines the appropriate sales price for affordable units every five years; in other years, the price is increased according to the

⁶ Montgomery County Ordinance, 25A-5(c)(3). Income limits are adjusted each year and are available at the DHCA website, <http://hca.montgomerycountymd.gov/Housing/MPDU/mpdu.htm>.

⁷ Montgomery County Ordinance, 25A-3(g).

⁸ Montgomery County Ordinance, 25A-7(a).

Consumer Price Index.

The MPDU program provides that the maximum sales price of an affordable housing unit during the ten-year control period shall be the original sales price plus the following factors:

- (a) A percentage of the unit's original sales price equal to the increase in the cost of living since the unit was first sold, as determined by the Consumer Price Index for All Urban Consumers (CPI-U);
- (b) The fair market value of improvements made to the unit between the date of original sale and the date of resale;
- (c) An allowance for closing costs which were not paid by the initial seller, but which will be paid by the initial buyer for the benefit of the later buyer;
- (d) A reasonable sales commission if the unit is not sold during the priority marketing period to an eligible person from the Department's eligibility list.⁹

Alternatively, the upper limit on the resale price may instead be reduced if the unit has suffered abnormal wear and tear due to neglect, mistreatment, or poor maintenance.¹⁰

These factors are included in the sales price in order to guarantee that the MPDU owners do not lose money on their investments. However, compensation for improvements to the property is limited to those improvements allowed by the MPDU program. A list of approved improvements is available on the DHCA website.¹¹ Given these restrictions, it is unlikely that the value attributed to the improvements would be significant enough to render the sales price of the housing unaffordable.

B. Selecting an Eligible Buyer

The DHCA has the right of first refusal for sixty days to purchase the affordable unit from the seller at the affordable price. If the DHCA does not elect to purchase the unit, then the DHCA must notify eligible buyers of the resale.¹² Once the eligible buyers are notified, the DHCA can either give certain potential buyers priority through a lottery, or give the seller permission to sell to any eligible buyer. The County Executive may set certain requirements for the sale through administrative regulations. For example, the seller may be required to provide the DHCA with copies of the proposed sales contract and other documents verifying the legitimacy of the sale.¹³

The DHCA establishes a "priority marketing period" in which the seller must seek a buyer who has been issued a certificate of eligibility by the DHCA. Individuals may only purchase 2-bedroom or smaller units, a 2-person and larger household may purchase a 3-bedroom unit, and 4-bedroom units are restricted to 4-person households and larger. If at the end of this period there has not been a sale, then the seller is free to offer the housing unit to the general public. The price of the MPDU remains the same, and all of the controls remain in effect. Montgomery

⁹ Montgomery County Ordinance, 25A-9(a).

¹⁰ Montgomery County Ordinance, 25A-9(a).

¹¹ Available at <http://hca.montgomerycountymd.gov/Images/PDF/improvement%20list.pdf>.

¹² Montgomery County Ordinance, 25A-9(b)(1).

¹³ Montgomery County Ordinance, 25A-9(b)(3).

County will extend the priority market period until everyone on the lottery list has been contacted before it offers the affordable unit to the general public.¹⁴

C. Sale after the Expiration of the Control Period

Affordable homeownership units are subject to price controls for a ten-year period. However, if the unit is sold to an eligible buyer within ten years after its initial sale, then the unit is treated as a new sale and a new ten-year control period begins.¹⁵ After the expiration of the ten-year control period, the affordability limits are no longer tied to the housing unit. However, if the DHCA purchases the affordable unit and resells it to an eligible buyer after the control period ends, a new ten-year control period starts from the date of sale.¹⁶ This creates an opportunity for the DHCA to guarantee a consistent supply of affordable housing.

If the control period expires and the DHCA does not purchase the housing unit, then the seller can put the house on the open market. When the sale is completed, the seller must pay the Housing Initiative Fund “one-half of the excess of the total resale price over the sum of the following:

- (a) The original selling price;
- (b) A percentage of the unit's original selling price equal to the increase in the cost of living since the unit was first sold, as determined by the Consumer Price Index for All Urban Consumers (CPI-U);
- (c) The fair market value of capital improvements made to the unit between the date of original sale and the date of resale; and
- (d) A reasonable sales commission.”¹⁷

This amount can be adjusted to guarantee that the seller retains at least \$10,000 of the excess in the sales price. This enables the seller to get a fair return for his or her investment.

Although Montgomery County does not make use of a monitoring agent as Massachusetts does, the administrators of this program have found the system to be successful. The legal restrictions on the property have been an effective mechanism for guaranteeing the affordability of housing. Homeowners and their lawyers tend to comply with the deed restrictions because any sale that fails to adhere to these requirements would be illegal and voidable.¹⁸

III. San Diego, California

San Diego's inclusionary zoning ordinance does not contain an affordability control period for owner-occupied units. However, the city designed an incremental system by which equity from the sale of the affordable unit is split between the City and the homeowner if the home is sold within the first 15 years of homeownership. A homeowner is entitled to a larger share of the

¹⁴ Interview of Eric Larsen, MPDU Program Administrator, August, 2003.

¹⁵ Montgomery County Ordinance, 25A-3(g).

¹⁶ Montgomery County Ordinance, 25A-9(c)(3).

¹⁷ Montgomery County Ordinance, 25A-9 c (3).

¹⁸ According to Bernie Tertrault of Montgomery County, former administrator of the MPDU Program.

equity for each year of ownership. For example, if a unit is sold after two years the owner is entitled to 21% of the equity, whereas a unit sold after ten years entitles an owner to 69% of the equity. If a home is resold within the first fifteen years, the shared equity agreement restarts and applies to the new buyer for the subsequent 15 years. All funds collected by the City from the shared equity agreement are deposited in the Inclusionary Housing Fund to support affordable housing projects. The City is also entitled to a right of first refusal on any for-sale unit, regardless of the period of homeownership.

IV. Community Land Trusts

The Institute for Community Economics (ICE) developed the Community Land Trust model (CLT) in the 1960's with the purpose of creating affordable housing supplies that could be controlled locally. A CLT is a nonprofit organization that owns real estate in order to make it available to low-income households.

A. Land Leases

CLTs acquire land as well as buildings. Housing units can be owned by those who occupy them, but the land is permanently held by the CLT and only leased to the homeowners. The lease is usually in the range of ninety-nine years, which generally enables the homeowners to use the land for as long as they desire. The lessee has a one-time option of renewing the lease at the end of the ninety-nine year period. Yet the fact that the CLT retains ownership of the land means the costs of the land are permanently limited, which guarantees lower housing costs over time.¹⁹

In the event that the CLT decides to sell the land, the lease remains in effect under the new owner. However, if the CLT attempts to sell the land to anyone other than a nonprofit corporation, charitable trust, governmental agency, or other similar entity sharing the CLT goals, the lessee has the right of first refusal on the purchase of the land.²⁰ If the lessee is not given the opportunity to exercise this right, any sale is void.

B. Setting an Affordable Sales Price

Any buildings, structures, fixtures, and other improvements purchased by the lessee or constructed by the lessee on any part of the leased land shall be the property of the lessee.²¹ The first step in the sale of property and transfer of rights to the land is the lessee's written notice to the CLT of intent to sell.²² Within ten days of the CLT's receipt of the notice, the CLT and the lessee must agree upon and commission a licensed appraiser to determine the market value of the leased premises and the property owned by the lessee. The CLT pays for the appraisal services.

The sales price, or the "purchase option price," equals the price paid by the lessee at the time of

¹⁹ Information regarding the CLT structure was derived from the Revised Model CLT Ground Lease document provided by ICE. More detailed information is available in the form of a legal manual for CLT's that can be purchased from ICE at a cost of \$100.

²⁰ Revised Model CLT Ground Lease, Article 3.3.

²¹ Revised Model CLT Ground Lease, Article 7.1.

²² Revised Model CLT Ground Lease, Article 10.4.

sale, plus 25 percent of the increase in market value.²³ This enables the lessee to share in the profit that stems from increased market value and improvements to the property. The increase in the market value is calculated using the appraisal value for the property owned by the lessee. This amount, less the appraisal value at the time the property was purchased, is the increase in market value. Then 25 percent of this increased value is added to the price originally paid by the seller, and that is the purchase option price. The CLT may also add an additional percentage of the increase in market value to the final sales price in order to cover some of their administrative fees. Despite the fact that housing values are rising significantly in many parts of the country, adding this portion of the market value to the sales price does not interfere with the affordability of the property. One CLT suggested that income levels would actually have to drop in order for this system to render housing unaffordable.²⁴

If the calculated purchase option price turns out to be higher than the current appraised value, the purchase option price will instead be this appraised value. This would mean that either the value of the property has deteriorated and the lessee has to absorb some of this loss, or the value did not increase as anticipated and the lessee's share in the profit must correspond to the actual increase in value.

C. Selecting an Eligible Buyer

Article 10.1 of the Revised Model Community Land Trust Ground Lease clearly states that the purpose of the lease is to keep the housing affordable for low-income households. The CLT, as lessor, reserves the right to buy back the home or other improvements to the land when a lessee decides to sell. The land-lease agreement guarantees the CLT forty-five days from receipt of the appraisal to exercise their right of first refusal. The purchase must then be completed within sixty days of the CLT's notification of intent to purchase.

If the CLT does not take the opportunity to purchase the property or the right to do so expires, the lessee must sell to an income-qualified buyer. An income-qualified buyer is a household whose total income does not exceed a certain percentage of the area median income.²⁵ This percentage varies among different CLT's. Most CLT's assume 1.5 people per bedroom in their affordable housing units.²⁶ If, for example, a three-bedroom home matches up to a household of 4.5 people, then the CLT takes the average of the maximum incomes for four- and five-person households as the maximum income for eligible households. The lessee may recommend a prospective buyer who meets the income qualifications. The CLT is required to make reasonable efforts to secure this person a purchase option, unless the CLT believes that affordable housing objectives would be better served with a different buyer. All sales are subject to review by the CLT.

If the property is not sold to a qualified buyer after six months, then the lessee may sell to any buyer, regardless of qualifications. However, the sales price in every case must be the same restricted affordable price – the purchase option price – regardless of whether the buyer is the

²³ Revised Model CLT Ground Lease, Article 10.9.

²⁴ Telephone interview with Mary Houghton of the Burlington Community Land Trust (August 2003).

²⁵ Revised Model CLT Ground Lease, Article 10.2.

²⁶ Houghton, *supra* note 22.

CLT, a low-income household, or any other buyer.²⁷ This aspect of the CLT model distinguishes it from the methods used in Massachusetts and Montgomery County. It guarantees that the housing remains affordable regardless of who ends up purchasing the property.

Once the sale is completed according to the guidelines of the seller's lease, the parties to the sale must establish a lease for the new owner. The CLT may either assign the seller's lease to the new buyer, or assign a new lease that includes the same rights, benefits, and obligations as the seller's old lease.²⁸ The restrictions run with the land regardless of who buys the property built upon it.

Conclusion

There are various ways to keep for-sale housing units affordable as ownership changes. The models from Massachusetts, Montgomery County, San Diego, and the Community Land Trust structure illustrate four distinct ways to balance policy considerations. Montgomery County, the CLT, and San Diego models enable homeowners to benefit from their investment even after they resell the property. Some methods require the services of a monitoring agent, some give the local community the right of first refusal at the time of resale, and some make it easier for units to be transferred to the open market. These models differ in implementation, but they have all found some measure of success in addressing the thorny issue of whether and how to keep for-sale units affordable over time.

²⁷ Revised Model CLT Ground Lease, Article 10.7.

²⁸ Revised Model CLT Ground Lease, Article 10.11.

Keeping For-Sale Affordable Units Created by Inclusionary Zoning Affordable Over Time

Municipality	Affordability Control Period	Income Target	Setting an Affordable Resale Price	Selecting an Eligible Buyer
Montgomery County, MD	99 years	<65% of the AMI for for-sale units	County Executive sets sales price affordable to low- and moderate-income households based on general market trends, the building industry, and area employers; updated every five years and increased according to the Consumer Price Index in intermediate years ²⁹	Department of Housing and Community Affairs (DHCA) has the right of first refusal; has 60 days to purchase affordable unit from the seller at an affordable price; DHCA must notify eligible buyers of the resale if it does not purchase the units; buyers chosen through a lottery or seller may sell to any eligible buyer; ³⁰ DHCA establishes priority marketing period during which seller can only sell to eligible buyers
San Diego, CA	None, but equity from the sale of the affordable unit is split between the homeowner and the city on an incremental scale up to 15 years of homeownership; the equity splitting agreement is lifted after 15 years of homeownership, but restarts with each resale	<65% of AMI for rental units and <100% AMI for for-sale units	Homeowners are entitled to a larger share of the equity for each year of ownership; e.g. if unit is sold after two years, the owner is entitled to 21% of the equity, and if unit is sold after ten years the owner is entitled to 69% of the equity; all funds collected are deposited in the Inclusionary Housing Fund	City entitled to right of first refusal for for-sale units
Burlington, VT	99 years	75% of the median income adjusted for household size	City limits equity appreciation to an amount that does not exceed 25% of the increase in the inclusionary unit's value, as determined by the difference between fair market appraisal at the time of purchase and a fair market appraisal at the time of resale, with adjustments for improvements and sales costs ³¹	City of Burlington Housing Trust Fund or a “designated housing agency” assigned by the Trust Fund has the right of first refusal to purchase any inclusionary unit for 90 days from the date on which the Housing Trust Fund is notified of its availability

²⁹Montgomery County Ordinance, 25A-7 (a).

³⁰Eligible buyers must be issued a certificate of eligibility by the DHCA.

³¹The Housing Trust Fund must approve adjustments.

Municipality	Affordability Control Period	Income Target	Setting an Affordable Resale Price	Selecting an Eligible Buyer
Cambridge, MA	50 years	Moderate-income households (65% of the Boston MSA)	Resale price is based on a formula that accounts for the original price, a calculation based on interest rates of equity earned for each year of ownership, and a factor for capital improvements ³²	City has the right of first refusal; city's Community Development Department runs a lottery of eligible buyers; preference is given to Cambridge residents, families with children under 18, with higher priority given to families with children under six years of age, and to families with emergency housing needs
Boulder, CO	Perpetuity	Average of HUD's definition of low income	Maximum sales price for affordable units is set on a quarterly basis by the city; the resale price for a permanently affordable unit is based on the original purchase price, closing cost, consideration of permanent home improvements, inflationary factor or shared appreciation factor	A developer or owner selects a low-income purchaser after completion of a good faith marketing and selection process approved by the city manager; the city also keeps a list of eligible homebuyers available upon request
Fairfax County, VA	15 years	<70% of the AMI	Resale price is based on the original sales price plus a percentage of the original sales price adjusted by the Consumer Price Index, the current market value of any structural improvements, and an allowance for closing costs	Eligibility based on obtaining a Certificate of Qualification from the Fairfax County Redevelopment and Housing Authority (FCRHA); for rental units, the landlord submits the following to the FCRHA on a monthly basis: the number of affordable units vacant, the number of units rented to eligible households, and evidence of a household's eligibility
Highland Park, IL	Perpetuity or as long as permissible by law	At least 50% of the units must be sold to low-income households. On average, the set-aside units must be affordable to households earning 65% of the AMI, remaining units sold to households earning 100% of the AMI on average	Restrictions on resale prices are not stated in the inclusionary zoning ordinance; rather each unit is required to include an as yet to be determined formula for the resale price in the deed restriction (the formula is developed by the Housing Commission)	Housing Commission or a city designated not-for-profit has the right of first refusal

³²Interview of Robert Vining, City of Cambridge Inclusionary Zoning Administrator, August 2003.

